

**REGULAR MEETING OF THE
MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

**Tech Ranch
910 Technology Blvd., Suite A
Bozeman, Montana**

Thursday, August 24, 2006

AGENDA

- | | |
|---|-------------------|
| I. CALL TO ORDER | 8:30 a.m. |
| A. Roll Call | |
| B. Approval of the May 18, 2006 Regular Meeting Minutes | |
| C. Administrative Business | 8:40 a.m. |
| 1. Human Resource Committee Report | |
| 2. Audit Committee Report | |
| 3. Loan Committee Report | |
| D. Public Comment - <i>Public Comment on issues with Board Jurisdiction</i> | 9:00 a.m. |
|
 | |
| II. REAL ESTATE PORTFOLIO | 9:05 a.m. |
| A. Introduction: Real Estate Asset Class Review – RV Kuhns | |
| B. Consultant Real Estate Presentation | |
| C. Real Estate Guidelines/Staff Recommendation/Decision | |
| D. Investment Activity - Verbal | |
|
 | |
| III. BOND PROGRAM – Carroll South | 10:30 a.m. |
| A. INTERCAP | |
| 1. Activity Report | |
| 2. Staff Approved Loans Report | |
| 3. Loan Requests | |
| 4. Preliminary Resolution – Additional INTERCAP Bonds | |
|
 | |
| IV. MONTANA IN-STATE LOAN PROGRAM – Herb Kulow | 10:45 a.m. |
| A. Commercial and Residential Portfolios Report | |
|
 | |
| QUARTERLY PERFORMANCE REPORTS – (To be provided RVK) | 11:00 a.m. |
| RV Kuhns & Cliff Sheets, CFA, CIO | |
|
 | |
| LUNCH | 12:00 p.m. |
|
 | |
| V. EXECUTIVE DIRECTOR REPORTS - Carroll South | 1:00 p.m. |
| A. Legislative Update – Information | |
| B. Pensions & Investments – Information Hand Out | |
| C. Asset Allocation Impact on Returns - Information | |
| D. Functional Organization/Revised Job Descriptions – Decision | |
| E. International Malting Company, LLC. – Request for Extension/Decision | |

- VI. Asset Allocation Policy Recommendations - Cliff Sheets, CFA, CIO 1:30 p.m.**
- A. Public Equities
 - 1. International - Decision
 - 2. Domestic - Decision
 - B. Bond Pools - Decision
 - C. Retirement Plans - Decision

- VII. INVESTMENT ACTIVITIES/REPORTS – Cliff Sheets, CFA, CIO 2:15 p.m.**
- A. Introduction of Research Director
 - B. Private Equity (MPEP)
 - 1. Portfolio Holdings and Recent Activity
 - 2. Pacing Study
 - C. Update on Domestic Equity Transition
 - D. Retirement System Asset Allocation Report
 - E. Update on International Manager Search and Transition
 - F. Investment Strategies
 - 1. MDEP
 - 2. MTIP
 - 3. Fixed Income
 - G. Policy Approvals
 - 1. Short-Term Investment Pool (STIP)

ADJOURNMENT 4:00 p.m.

The Board of Investments makes reasonable accommodations for any known disability that may interfere with a person's ability to participate in public meetings. Persons needing an accommodations must notify the Board (call 444-0001) or write to P.O. Box 200126, Helena, Montana 59620) no later than three days prior to the meeting to allow adequate time to make needed arrangements.

**MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE**

**TechRanch
910 Technology Blvd., Suite A
Bozeman, Montana**

Thursday, August 24, 2006

MINUTES

BOARD MEMBERS PRESENT:

Terry Moore, Chairman
Teresa Cohea
Karen Fagg
John Paull
Jack Prothero
Jim Turcotte
Calvin Wilson

BOARD MEMBERS ABSENT:

Elouise Cobell
Maureen Fleming

STAFF PRESENT:

Robert T. Bugni, CFA, Portfolio Manager
Geri Burton, Deputy Director
Richard Cooley, CFA, Portfolio Manager
Kimberly Dallas, Program Assistant/Board Secretary
Ed Kelley, Portfolio Manager
Rande Muffick, CFA, Portfolio Manager
Nancy Rivera, Credit Analyst
Clifford A. Sheets, CFA, Chief Investment Officer
Carroll V. South, Executive Director
Dan Zarling, CFA, Director of Research

GUESTS:

Becky Gratsinger, R.V. Kuhns and Associates
Michael Humphrey, Managing Principal, Courtland Partners, Ltd.
Joshua Kaye, Analyst, Courtland Partners, Ltd.

CALL TO ORDER

Chairman Moore called the regular meeting of the Board of Investments (Board) to order at 8:30 a.m. in the conference room at TechRanch, 910 Technology Blvd., Suite A, Bozeman, Montana. As noted above, the meeting convened with 7 members of the Board present. Member Fleming and Member Cobell were absent.

Member Wilson motioned for approval of the May 18, 2006 minutes; Member Paull seconded the motion and the motion was passed 7-0.

PUBLIC COMMENT

Chairman Moore called for Public Comment of Board-Related Items. *No Public Comment was made.*

ADMINISTRATIVE BUSINESS

Chairman Moore presented the following Administrative Business:

- Board Member Jim Turcotte has requested approval to attend the Defined Contribution Conference in San Francisco, October 8 – 10, 2006. The cost of the trip will be approximately \$1,200. This includes transportation (\$344), registration (\$200), meals (\$100), misc. expense (\$100) and lodging (\$450). Member Wilson motioned for approval of this request; Member Paull seconded the motion and the motion was passed 7-0.

Human Resources Committee Report

Terry Cohea reported to the Board that the Human Resource Committee has reviewed the performance of Cliff Sheets and is recommending that the employment contract for Mr. Sheets be extended for three years and the base salary be increased by \$5,000 and that Mr. Sheets receive a \$10,000 performance bonus for the last half of this fiscal year as provided for in the pay plan. The Committee is very pleased with Mr. Sheets' performance to date in diversifying existing pension portfolios, and starting the investments in real estate and in selection of the external managers. The Committee has determined that the three-year extension of the contract is necessary to provide adequate time for Mr. Sheets to continue his efforts to carry out the recommendations of the Asset Liability Study.

Member Wilson motioned for approval of the recommendation of the Human Resource Committee; Member Turcotte seconded the motion and the motion was passed 7-0.

Loan Committee Report

Member Prothero, Chairperson of the Loan Committee, presented the following loan request receiving Loan Committee approval. The Loan Committee authorized staff to proceed with processing and closing this loan using the Board's standard Bond Program Office procedures:

Borrower:	Town of St. Ignatius
Purpose of Loan:	An interim loan in anticipation of Rural Development long term financing for water system improvements.
Amount of Loan:	\$1,465,000
Loan Committee Decision:	The Committee authorizes staff to proceed with processing and closing the loan using the Board's standard Bond Program Office procedures.

Member Prothero, Chairperson of the Loan Committee, presented the following loan requests receiving Loan Committee approval. The Loan Committee authorized staff to proceed with processing and closing the following loans using the Board’s standard Commercial Loan Program procedures:

Borrower:	Cape-France Enterprises and JoAnn Cape
Lender:	Rocky Mountain Bank, Bozeman
Purpose of Loan:	To provide long term financing for the construction of an “Old Chicago” restaurant in Billings.
Amount of Loan:	\$1,800,000
Board Loan Amount:	\$1,260,000
Board Participation:	70%
Term of Loan:	20 Years
Interest Rate:	7.31% + .35LSF = 7.36% Fixed
Loan Committee Recommendation:	Approval, subject to the terms and conditions in Schedule A.

Borrower:	Central Mechanical, LLC.
Lender:	Mountain West Bank, Great Falls
Purpose of Loan:	To provide long term financing for the construction of a new warehouse and office space.
Amount of Loan:	\$2,100,000
Board Loan Amount:	\$1,680,000
Board Participation:	80%
Term of Loan:	15 Years
Interest Rate:	7.23% + .50 LSF = 7.73% Fixed
Loan Committee Recommendation:	Approval, subject to the terms and conditions in Schedule A.

Borrower:	GMRP, LLC.
Lender:	First Interstate Bank, Missoula
Purpose of Loan:	To provide long term financing for the construction of a new 18,400 sq. ft. commercial/retail building.
Amount of Loan:	\$1,625,000
Board Loan Amount:	\$1,300,000
Board Participation:	80%
Term of Loan:	25 Years
Interest Rate:	6.84% + .55% LSF = 7.39% Fixed
Loan Committee Decision:	Approval, subject to the terms and conditions in Schedule A.

International Malting Company, LLC. – Request for Extension

Mr. Carroll South reported that International Malting Company, LLC. has requested a 90-day extension for each of their three loan commitments. The Board approved three loans to International Malting Company, LLC. at its August 7, 2003 Board meeting. Given the size and complexity of this project as well as the financial complexity, staff recommends approval of the 90-day extension to all of the loan commitments. This extension would be an exception to Board policy, and there would be no fee charged for the additional 90-day extension.

The Loan Committee approved this request, with the extension dated from today (August 24, 2006) for 90-days. Member Prothero motioned for approval of this request; Member Wilson seconded the motion and the motion was passed 7-0.

REAL ESTATE PORTFOLIO PRESENTATION

Mr. Cliff Sheets introduced Becky Gratsinger. Ms. Gratsinger gave a very brief review of what has taken place to establish the Real Estate Portfolio.

Mr. Sheets presented to the Board staff recommendation that the Board approve the Real Estate Investment Guidelines and Ranges as the basic document governing real estate investment in the Montana Real Estate Pool (MTRP). Member Fagg motioned for approval of staff recommendation as presented; Member Wilson seconded the motion and the motion was passed 7-0.

Mr. Cliff Sheets gave a brief update on the investment activity in Real Estate. At the May Board meeting the decision was made to add Real Estate as a new asset class with a target allocation of 5% of the total retirement portfolio. In June, arrangements were finalized to retain the services of Courtland Partners to assist in building the non-core segment of the portfolio.

Mr. Sheets reported that the following non-core funds have been reviewed:

- Fillmore
- Westport
- CIM Urban REIT
- Apollo – committed \$10 mm
- Angelo Gordon – committed \$20 mm
- Alex Brown
- Urdang
- Carlyle

Mr. Sheets reported that the following Core Funds have been reviewed:

- ING Clarion
- INVESCO
- JP Morgan
- Prudential – PRISA

More manager interviews will be scheduled during September and October.

QUARTERLY PERFORMANCE REPORTS

Mr. Cliff Sheets and Ms. Becky Gratsinger presented to the Board the Quarterly Performance Report for the period ending June 30, 2006.

BOND PROGRAM

INTERCAP Bond – Preliminary Resolution No. 212

Mr. Carroll South presented staff request for authorization to issue a new \$15M bond, Series 2007, for the purpose of providing funds for the INTERCAP Revolving Loan Program (the “Program”).

The purpose of the Preliminary Resolution is:

- ✓ to give preliminary approval to the issuance of bonds under the Municipal Finance Consolidation Act in an amount up to \$15 million.
- ✓ to allow staff to work with the current INTERCAP Program finance team to prepare the necessary documents to accomplish the sale.
- ✓ to authorize the issuance of bond anticipation notes should it be necessary to borrow from the Board as may be required to meet the needs of the Program prior to the issuance of bonds.

Because the new issue will coincide with the remarketing of the outstanding bonds on March 1, the Board's final resolution authorizing the approval of the Series 2007 bonds will take place during the regular Board meeting scheduled December 1, 2006.

Staff recommends that the Board:

1. Authorize staff to take steps as deemed necessary to issue up to \$15 million in INTERCAP bonds for a term of 25 years;
2. Authorize the issuance of bond anticipation notes;
3. Adopt the INTERCAP Preliminary Resolution No. 212;
4. Authorize the current INTERCAP Program finance team to provide the expertise to issue/underwrite the bonds.

Member Prothero motioned for approval of staff request as presented; Member Cohea seconded the motion and the motion was passed 7-0.

Activity Report

The Board reviewed this report for the period ending June 30, 2006.

Staff Approved Loans Report

Mr. Carroll South reported that:

Borrower:	Boulder
Purpose:	To finance costs associated with a preliminary engineering report (PER).
Staff Approval Date	May 1, 2006
Board Loan Amount:	\$25,000
Term:	6 years

Borrower:	Lewis & Clark County
Purpose:	To refinance its Public Works Department road grader lease.
Staff Approval Date	May 2, 2006
Board Loan Amount:	\$539,166
Term:	7 years

Borrower:	Department of Natural Resources and Conservation (DNRC)
Purpose:	Interim loan in anticipation of issuing state general obligation bonds. The funds are a match for the federal funds from the Environmental Protection Agency to fund DNRC's Water Pollution Control State Revolving Fund (WPCSRF) Loan Program.
Staff Approval Date	May 3, 2006
Board Loan Amount:	\$1,000,000
Term:	1 year or less

Borrower:	Hungry Horse Co. Water & Sewer District
Purpose:	<i>Increase</i> to \$611,000 loan Board approved January 2004 for an interim loan in anticipation of Rural Development (RD) long term financing for water system improvements for the District.
Staff Approval Date	May 3, 2006

Board Loan Amount:	\$214,000 increase to this loan; \$825,000 total loan.
Term:	Interim financing (up to 3 years)

Borrower:	Beaverhead County
Purpose:	<u>Increase</u> to \$85,000 loan staff approved July 2005 to finance costs associated with fairground restroom facility improvements.
Staff Approval Date	May 11, 2006
Board Loan Amount:	\$23,000 increase to this loan; \$108,000 total loan.
Term:	10 years

Borrower:	Frenchtown School District #20
Purpose:	To finance a land acquisition.
Staff Approval Date	May 17, 2006
Board Loan Amount:	\$135,000
Term:	3 years

Borrower:	Lewistown
Purpose:	<u>Increase</u> to \$355,000 loan staff approved April 2006 to finance the costs associated with wastewater collection system improvements and including 10% reserve requirement.
Staff Approval Date	May 31, 2006
Board Loan Amount:	\$35,500 increase to this loan; \$390,500 total loan.
Term:	5 years

Borrower:	Lolo Elementary School District #7
Purpose:	To finance costs associated with various projects including replacing a storage building/bus garage including site work, paving, striping, and purchase a maintenance pickup with plow, a used fork lift, and storage shelving.
Staff Approval Date	May 30, 2006
Board Loan Amount:	\$400,000
Term:	3 years

Borrower:	Beaverhead County Water & Sewer District
Purpose:	Interim loan in anticipation of Rural Development (RD) long term financing for water system improvements.
Staff Approval Date	June 7, 2006
Board Loan Amount:	\$212,000
Term:	Interim financing (up to 3 years)

Borrower:	Plains
Purpose:	To finance the purchase of a new ambulance.
Staff Approval Date	June 16, 2006
Board Loan Amount:	\$85,000
Term:	7 years

Borrower:	Dayton/Lake County Water & Sewer District
Purpose:	<u>Increase</u> to \$2,732 loan staff approved September 2004 to finance costs associated with a preliminary engineering loan.

Staff Approval Date	June 19, 2006
Board Loan Amount:	\$1,057 increase to this loan; \$3,789 total loan.
Term:	3 years

Borrower:	Gallatin County
Purpose:	<i>Increase</i> to \$380,000 loan the Board approved April 2005 to finance the costs associated with fairground improvements.
Staff Approval Date	July 13, 2006
Board Loan Amount:	\$120,000 increase to this loan; \$500,000 total loan.
Term:	10 years

has been approved by staff.

EXECUTIVE DIRECTOR REPORTS

Legislative Update

Mr. Carroll South presented to the Board an update on Legislative activity taking place in anticipation of the upcoming Legislative Session. Currently, only hold-over Senators, House candidates without general election opponents, and interim legislative committees may request legislation. Staff expects more requests for pension-related legislation after the November general election and will continue to keep the Board informed.

Pension & Investments

Mr. Carroll South gave a verbal update on the Montana Pension Systems.

Asset Allocation Impact on Returns

Mr. Carroll South gave a verbal presentation on the Asset Allocation Impact on Returns.

Functional Organization/Revised Job Descriptions

Mr. Carroll South presented to the Board two revised job descriptions for positions currently filled by Ed Kelly and Rich Cooley. The revisions being presented transfer Short Term Investment Pool (STIP) portfolio management from Ed Kelly to Rich Cooley. This change will allow Mr. Kelly to devote full time to private equity and real estate. Mr. Cooley has past STIP management experience.

Mr. South also proposed a revision be made to the functional organizational chart. The revised chart moves the “Fixed Income/External Manager” position under the direct supervision of the Chief Investment Officer.

Mr. South presented staff recommendation that the Board approve the revised job descriptions and the proposed functional organizational chart. Member Prothero motioned for approval of staff recommendation as presented; Member Cohea seconded the motion and the motion was passed 7-0.

Adjourn – The meeting adjourned for lunch at 12:20 p.m.

Reconvene – The meeting reconvened at 1:00 p.m.

CHIEF INVESTMENT OFFICER REPORTS

Asset Allocation Recommendation – International Equity Pool

Mr. Cliff Sheets presented staff recommendation that the Board approve the proposed changes to the asset allocation policy for the International Equity Pool. The recent RFP for international equity management services was designed to enable staff to restructure the pool into a framework that is more consistent with current practices. The new pool structure will be a more diversified and actively managed portfolio. The new structure will also provide more opportunity to add value to the pool.

Member Turcotte motioned for approval of staff recommendation as presented; Member Wilson seconded the motion and the motion was passed 7-0.

Asset Allocation Recommendation – Domestic Equity Pool

Mr. Cliff Sheets presented staff recommendation that the Board approve the proposed changes to the asset allocation policy for the Domestic Equity Pool. The proposed ranges were designed to provide flexibility to make potential changes that staff may recommend at a future date to provide further manager diversification.

Member Prothero motioned for approval of staff recommendation as presented; Member Fagg seconded the motion and the motion was passed 7-0.

Asset Allocation Recommendation – Bond Pool

Mr. Cliff Sheets presented staff recommendation that the Board approve the proposed changes to the sector asset allocation policy for the Retirement Fund and Trust Fund Bond Pools.

Member Fagg motioned for approval of staff recommendation as presented; Member Paull seconded the motion and the motion was passed 7-0.

Asset Allocation Recommendation – Teachers' Retirement System

Mr. Cliff Sheets presented staff recommendation that the Board approve the proposed changes to the Teachers' Retirement System asset allocation policy, as well as the other retirement plan portfolios until distinct asset allocation policies are advisable. The proposed changes are described as follows:

1. Domestic Public Equities: Increase the width of the range while lowering the bottom of the range. This will provide for added flexibility in altering the domestic and international mix of public equities, and is consistent with a higher-than-current long-term preference for international equities as suggested by the asset allocation study.
2. International Public Equities: Increase the width of the range while increasing the bottom of the range. We are currently capped out in non-US equities at 18%. This change will allow for a greater allocation to international equities over time.
3. Real Estate: Increase the allocation to accommodate the plan to add 5% to real estate over the next three years.
4. Fixed Income: Reduce the allocation. This asset class is expected to fund much of the increase in real estate.
5. Private Equity: Increase the level of the range to 5-10%. The current exposure is 5.7% with a target of 7%. An increase in the target to 8-10% is recommended.

Member Turcotte motioned for approval of staff recommendation as presented; Member Prothero seconded the motion and the motion was passed 7-0.

INVESTMENT ACTIVITIES/REPORTS

Montana Private Equity Pool (MPEP)

Mr. Ed Kelly and Mr. Cliff Sheets presented various reports on MPEP. These reports included the Holdings Report as of June 30, 2006 and the Cash Flow Analysis Report. No action is required on these reports.

Mr. Ed Kelly presented to the Board four investment briefs:

1. CCMP Capital Investors Fund II – On August 14, 2006, staff committed \$30 million to the CCMP Capital Investors Fund II.
2. First Reserve Corporation Fund XI – On July 27, 2006, staff committed \$30 million to the First Reserve Corp Fund XI.
3. J.C. Flowers Fund II – On July 14, 2006, staff committed \$25 million to the J.C. Flowers Fund II.
4. Lehman Bros. Co-Investment Fund I – On August 9, 2006, staff committed \$35 million to the Lehman Brothers Co-Investment Fund.

Domestic Equity Transition - Update

Mr. Cliff Sheets updated the Board on the transition of \$500 million of assets from the internally-managed large cap portfolio to the four new enhanced index managers. This was completed in May. The four new managers, each of whom received one-fourth of the total, or approximately \$125 million each are: Western Asset Management, T. Rowe Price, Goldman Sachs Asset Management and Enhanced Investment Technologies (INTEC).

Update on International Manager Search and Transition

Mr. Cliff Sheets reported that the selection of international equity managers was completed at the end of June. The new managers selected and their respective categories are as follows:

<u>Core</u> Batterymarch Julius Baer BGI ACWI ex-US Alpha Tilts Fund	<u>Value</u> Acadian Bernstein
<u>Growth</u> Martin Currie Hansberger Principal Global Investors	<u>Small Cap</u> AXA Rosenberg

Contracts are currently being finalized and transition will be completed at the end of the quarter.

Policy Approvals

The Short-Term Investment Pool (STIP) Investment Policy Statement was presented to the Board for approval. Member Turcotte motioned for approval of Investment Policy Statement as presented; Member Cohea seconded the motion and the motion was passed 7-0.

NEXT MEETING

The next regularly scheduled meeting of the Board will be November 30 and December 1, 2006.

ADJOURNMENT

There being no further business, the August 24, 2006 regular meeting of the Board was adjourned at 3:30 p.m.

BOARD OF INVESTMENTS

APPROVE: _____
Terry Moore, Chairman

ATTEST: _____
Carroll South, Executive Director

DATE: _____